Franchise Tax Board

SUMMARY ANALYSIS OF AMENDED BILL

Author: Lowenthal/Cedillo Analyst: Angela Raygoza Bill Number: SB 713

Related Bills: See Prior Analysis Telephone: 845-7814 Amended Date: June 4, 2007

Attorney: Dan Biedler Sponsor: ______

SUBJECT: Farmworker Housing Credit/Partner's Distributive Share of Credit is Determined By Partnership Agreement

_____ DEPARTMENT AMENDMENTS ACCEPTED. Amendments reflect suggestions of previous analysis of bill as introduced/amended __________________.

__X__ AMENDMENTS IMPACT REVENUE. A new revenue estimate is provided.

_____ AMENDMENTS DID NOT RESOLVE THE DEPARTMENT'S CONCERNS stated in the previous analysis of bill as introduced/amended ____________________.

_____ FURTHER AMENDMENTS NECESSARY.

_____ DEPARTMENT POSITION CHANGED TO ____________________.

__X__ REMAINDER OF PREVIOUS ANALYSIS OF BILL AS AMENDED April 19, 2007, STILL APPLIES.

__X__ OTHER – See comments below.

SUMMARY

This bill would consolidate the farmworker housing tax credit (FHTC) program into the state low-income housing tax credit (LIHC) program and make changes to how the state LIHC may be allocated to partners.

SUMMARY OF AMENDMENTS

The June 4, 2007, amendments would add language to specify how the LIHC shall be distributed to the partners of a partnership when allocated after January 1, 2008. As a result of these amendments, the "This Bill" and "Economic Impact" discussions provided in the department's analysis of the bill as amended April 09, 2007, have been revised. A new Technical Concern has also been identified and is included below. In addition, the policy concern as discussed in the April 09, 2007, analysis has been added below for your convenience. Except for the discussion in this analysis, the remainder of the department's analysis of the bill as amended April 09, 2007, still applies.

Board Position:			Legislative Director	Date
_______ S	_______ NA	_______ NP		
_______ SA	_______ O	_______ NAR	Brian Putler	6/21/07
_______ N	_______ OUA	__X__ PENDING		

THIS BILL

This bill would do the following:

- Repeal the farmworker housing assistance program from the Health and Safety Code.
- Add new language to the Health and Safety Code requiring the farmworker housing credit to be allocated in the same manner as the LIHC.
- Specify a minimum amount of credit that should be set aside for projects housing farmworker households that is in addition to the LIHC.
- Define “agricultural worker” or “farmworker” as specified in the Labor Code.
- Require that shares of the LIHC allocated on or after January 1, 2008, be distributed to partners based on the partnership agreement regardless of whether the federal LIHC is distributed or the agreement has substantial economic effect within the meaning of Section 704 (b) of the Internal Revenue Code,

TECHNICAL CONSIDERATIONS

This bill would provide that the LIHC be distributed to the partners of a partnership owning the project in accordance with the partnership agreement. Under the tax accounting rules applicable to partnerships (found in Subchapter K of the Internal Revenue Code, to which California conforms), credits are technically "allocated" among partners rather than "distributed." Amendments 1, 2, and 3 have been provided to correct this technical error.

ECONOMIC IMPACT

Revenue Estimate

This bill would result in the following revenue losses:

Revenue Analysis for SB 713 – Amended on June 24, 2007 Operative January 1, 2008 Enactment assumed after June 30, 2007 ($ in Millions)			
Fiscal Year	2007-08	2008-09	2009-10
Farmworker Housing (FWHC)	Loss < $250K	Loss < $250K	Loss < $250K
Low Income Housing** (LIHC)	$0	$0	$0

**The LIHC provisions of this bill would not have a revenue impact until fiscal year 2011-12, in which the provisions would result in a revenue loss of $1.6 million. Losses increase each year thereafter. When fully phased in the 2014-15 fiscal year, the estimated annual revenue losses would be $3.2 million, consisting of approximately $2.4 million in accelerated credit usage and approximately $0.8 million of reduced taxes from capital losses on abandonment.

This estimate does not consider any possible changes in employment, personal income, or gross state product that could result from this bill.

The June 4, 2007, amendments specify that the new division of the federal-state LIHC would apply prospectively for reservations made on or after January 1, 2008. Due to the estimated three-to-four-year lapse period from the date of preliminary reservation to the date final allocation is given, the revenue impact from accelerated credit usage would not occur until the 2011 tax year. The corresponding fiscal effect would therefore be outside the normal budget window.

Revenue Discussion

It is estimated that in fiscal year 2011-12, 50% of the currently unused credit would be applied under this bill resulting in roughly $1.5 million in revenue losses.

Under this bill, partnerships (including a limited liability company taxed as a partnership) would be allowed to structure their formative agreements such that some partners and members can own shares of the state LIHC that are disproportionate to their economic interest in the project. In such cases, a partner or member who purchases the divided state LIHC will still have an incentive to walk away after their credits are claimed for tax purposes. This situation continues to result in a capital loss equal to the investment of the partnership. This estimate assumes no more than 10% of future credit allocations would result in a capital loss on abandonment in any given year.

For the first impact year of the abandonment loss (2011), it is assumed that the bill would result in capital losses equal to 2.5% of the credits generated that year. Based on a projected $85 million in state LIHC generated in 2011, the amount of capital losses generated in the 2011 tax year would be about $2 million ($85 million X 2.5%). Because most partners are corporations, the $2 million is multiplied by an 8.84% tax rate to arrive at a state revenue loss of $0.2 million. It is assumed that in later years, the amount of capital losses generated from abandonment would equal 10% of state LIHC credits generated, equal to around $1 million in total in the year 2014.

POLICY CONCERNS

This bill would disconnect ownership of the property from eligibility for the credit, thus severing the credit from a taxpayer's economic interest in the profits and losses of the project. Because the Committee could issue this credit to any partnership, corporation, or business entity, this action could lead to allocations for tax shelter purposes. For example, investors would be able to "buy" rights to farmworker housing credits through the purchase of a partnership share. When all of the credits, which could exceed the cost of investment, have been utilized, the investor could walk away from the partnership with negative income to apply against other partnership income. Thus, the investor would benefit twice from the arrangement: first by use of the credit and second by the income loss. As discussed in the department's analysis of the bill as amended on April 9, 2007, Governor Davis vetoed a similar proposed change to the low-income housing credit on September 30, 2000, citing concern with "abuses that may arise" from the severance of economic interest in the project and the potential for allocations being obtained for tax shelter purposes.

LEGISLATIVE STAFF CONTACT

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FRANCHISE TAX BOARD'S
PROPOSED AMENDMENTS TO SB 713
As Amended June 4, 2007

AMENDMENT 1

On Page 3, line 36, strikeout "distributed to" and insert:

allocated among one or more of

AMENDMENT 2

On Page 13, line 10, strikeout "distributed to" and insert:

allocated among one or more of

AMENDMENT 3

On Page 22, line 39, strikeout "distributed to" and insert:

allocated among one or more of